

# AGENCY FOR INTERNATIONAL DEVELOPMENT PPC/CDIE/DI REPORT PROCESSING FORM

ENTER INFORMATION ONLY IF NOT INCLUDED ON COVER OR TITLE PAGE OF DOCUMENT

1. Project/Subproject Number 936-5315	2. Contract/Grant Number DAN-5315-A-00-2070-00	3. Publication Date 10/89
--	---	------------------------------

4. Document Title/Translated Title  
Informal Rural Credit in Thailand: An Overview

5. Author(s)  
1.  
2.  
3.

6. Contributing Organization(s)  
The Ohio State University

7. Pagination 32	8. Report Number	9. Sponsoring A.I.D. Office STT/RD + AFR/MOT
---------------------	------------------	---

10. Abstract (optional - 250 word limit)

11. Subject Keywords (optional)

1.	4.
2.	5.
3.	6.

12. Supplementary Notes

13. Submitting Official Melissa Bonnkerhoff	14. Telephone Number 875-4491	15. Today's Date 4/14/90
--	----------------------------------	-----------------------------

.....DO NOT write below this line.....

16. DOCID	17. Document Disposition DOCRD [] INV [] DUPLICATE []
-----------	--

**SEMINAR ON INFORMAL FINANCIAL MARKETS  
IN DEVELOPMENT**

Tongroj Onchan  
Department of Agricultural Economics  
Kasetsart University  
Bangkok

Sponsored by

The Ohio State University

The Agency for International Development

The World Bank

October, 18-20, 1989, Washington, D.C.

Informal Rural Credit in Thailand : An Overview <sup>1/</sup>

by Tongroj Onchan <sup>2/</sup>

**Introduction**

Farm credit policy has received close attention from the Thai government for many years. The first credit cooperative in 1936 aimed at providing cheap credit to the farmers, who were believed to be exploited by moneylenders. The cooperative system has undergone several structural changes and had many ups and downs since the 1960s. In 1969, the Bank of Agriculture and Agricultural Cooperatives (BAAC) replaced the Bank for Cooperatives, hoping to expand and improve its operations to cover farmers all over the country. The Bank of Thailand also came up with a new policy in 1975 to increase the farm credit supply to agriculture. They requested all commercial banks to channel five percent of their total outstanding value of lending at the end of 1974 to the farmers, either directly or through the BAAC. In the following years, the credit quota increased two percent annually, up to 13 percent. Since 1976 the quota has been fixed as a proportion of the total deposit of the commercial banks, remarkably increasing the amount of formal farm credit. Farm credit policy changed again in 1986 with the Bank of

-----  
1/

Paper presented at the Seminar on Informal Finance, held in Washington, D.C., 18-20 October 1989.

2/

Professor, Faculty of Economics and Business Administration, Kasetsart University, Bangkok.

Thailand's new "rural credit" policy. Rural credit is now conceived more broadly than before, covering both farm and non-farm activities. The proportion of lending has been raised to 20 percent of the total deposits of the commercial banks. This has actually made it easier for them to meet their minimum targets because loans granted to provincial non-farm entrepreneurs can also be included. Since the inception of its new credit policy in 1975, BAAC has also greatly expanded its operations. Deriving a good part of its loanable funds from deposits by commercial banks which do not make small agricultural loans, BAAC lends both to agricultural cooperatives and individual farmers.

Although there has been a phenomenal expansion of formal credit, the role of informal credit is still very significant. A great proportion of Thai farmers still borrow informally. Such credit appears to provide useful and necessary services to farmers, particularly the smaller and poorer ones. However, the Thai government and other concerned people still feel that farmers are being seriously exploited by moneylenders.

This paper discusses some aspects of the informal credit market, particularly its significance, structure and conduct. Although data on informal credit is usually limited, some studies have been conducted in recent years. I will also refer to the findings of our research team, particularly regarding the role of land collateral for farm credit. The

importance of land ownership in both formal and informal credit is highlighted.

### Significance of Informal Credit

It has generally been observed in Thailand and in other developing countries in Asia over the past few decades that, informal farm credit has declined in importance (Onchan, 1985). This has mainly been due to the great expansion of institutional credit. However, as shown in Table 1, informal credit continues to be very significant. Its share of the total farm credit is still around 30 percent, and most relatively small and poor farmers rely mainly on informal lenders for their credit needs. (Poaponsakorn and Natayarak, 1989). Due to a number of factors, particularly the lack of collateral, poor farmers do not have access to formal credit. Some formal lenders, notably the BAAC, have been trying to reach this group by using group guarantees instead of land collateral, but relatively few farmers have received loans. Many farmers occupy lands without proper legal documents (Onchan et. al., 1982). This is another obstacle to obtaining credit from banks or other formal sources. Thus, farmers often borrow informally, for credit for both production and consumption purposes. Given the slow progress of land reform and land titling programs, informal credit will remain important to the rural economy of Thailand for years to come.

Table 1: Size of Informal Credit in Thailand

Year	% of Informal Credit	
	No. of Borrowers	Value of Loan
<b>Whole Kingdom</b>		
1961/62	92.1	94.5
1972/73	72.2	63.7
1975/76	-	42.5
1978/79	-	36.1
1986/87	-	26.9
<b>Central Plain</b>		
1956/57	90.1	93.9
1961/62	97.7	97.0
1967/68	71.8	74.9
1978/79	-	39.7
1986/87	-	32.4
<b>Northeast</b>		
1961/62	92.4	89.2
1971/72	78.5	-
1972/73	29.4	17.4
1975/76	-	30.6
1978/79	-	31.2
1986/87	-	17.4
<b>North</b>		
1961/62	89.7	90.2
1971/72	54.0	39.3
1978/79	-	35.4
1986/87	-	31.4

- Source:
- 1) 1957 and 1967/68 : Udhis Naksawadi
  - 2) 1961/62 : Pantum Thisyamondol, Vinich Aromdee, and M.F. Leng, Agricultural Credit in Thailand, Kasetsart University, 1965.
  - 3) 1971/72 : Pantum Thisyamondol
  - 4) 1972: Pantum Thisyamondol
  - 5) 1975/76, 1978/79, 1986/87: Ministry of Agriculture and Cooperatives

## The Informal Credit Market : Structure and Conduct

The informal rural credit market in Thailand is similar to those in other developing Asian countries. Credit is available from friends and relatives, money-lenders, traders, landlords, and rich farmers. These lenders are often classified as non-commercial (friends and relatives) and commercial (money-lenders, traders, etc.). Each of these groups has different behavior patterns in their credit operations. Generally, friends and relatives do not lend primarily to maximize their profit or return, as moneylenders and traders do. However, some so-called "non-commercial lenders" also charge on-going rates of interest. In fact, they sometimes treat "family" <sup>1/</sup> borrowers just like commercial clients, (though some leniency may be practiced in regard to terms of credit.

There are several informal lenders in rural credit markets like the villages of Thailand. There is usually five to seven lenders per village (Poapongsakorn and Netayarak, 1989, Thani 1980, Dhaiyanonda' et. al. 1988). Of course, non-commercial lenders are difficult to identify since any farmer or villager may lend small amounts for short periods to his relatives or friends. Commercial lenders are more readily identified. The presence of several local lenders does not

-----  
1/

In the rural society, "relatives" or "family" is a rather loose term, people can be related in many ways. In farm credit, distant relatives or friends are usually treated as general villagers.

necessarily mean that the market is competitive. In many cases, farmer borrowers regularly deal with one particular lender. Switching to or borrowing from other lenders may be frowned upon by the original lender (Siamwalla, 1988). In fact, borrowing from more than one informal lender is not uncommon, but the borrower usually tries to keep it a secret from his major lender (Dhaiyanonda et. al. 1988 and also from own interview of farmers in Buri Ham province).

The informal lenders usually live in the same village. Outside lenders, including traders, also operated in the village with the help of local traders or village grocers who act as brokers. Lenders generally have good information about the villagers and their clients. Useful information includes ownership and size of land, size of family and outside or off-farm employment, type of farming and personal characteristics. Thai villagers are usually very close, related in some way, and are often joined in community development activities. The well-to-do farmers, local traders, and landlords who are lenders are also frequently village leaders. They know most, if not all, the villagers and can pressure their clients through social sanctions in cases of default.

When considering the importance of different types of informal lenders, relatives and friends have played a dominant role over time, although this has lessened somewhat during the

past twenty years (Table 2)<sup>1/</sup> Rentiers are another significant group also in decline as a source of credit. Other major lenders include rice traders, merchants and rice millers. Due to their importance in farm credit, relatives and friends deserve special attention if the behavior of informal lender's is to be understood.

Another aspect of informal lending is the source of the loanable funds. In Thailand, as in other countries, savings are most important. Lending funds may also be borrowed from formal sources. In the province of Nakhon Ratchasima, in Northeastern Thailand, savings constitute 34 percent of the total loanable funds<sup>2/</sup> while money borrowed from formal sources accounts for 22 percent (Poapongsakorn and Netayarak, 1989). Informal lenders may even borrow money among themselves to relend to the farmers, though the proportion is found to be rather small i.e., six percent in Nakhon Ratchasima.

-----  
1/

Data in Table 2 must be interpreted with caution. The research studies used different methodologies and covered different groups of farmers. Different definitions of some types of lenders were also used. The purpose of putting them together is mainly to indicate various types of lenders and their relative importance over time.

2/

In Chiang Mai, saving constituted over 90 percent of the total fund. However, the survey was done in 1979 and the sample size was rather small (Pichit, 1980).

Table 2: Type of Informal Lenders by Region and Year 1/

(Percent)

Year	Relatives & Friends	Farmer	Rentiers 2/	Rice Trader	Other Merchant	Rice-Mill	Landlord
<b>Central Region :</b>							
<b>Contracts</b>							
1957	37.0	-	21.0	9.0	10.0	2.0	8.0
1962	31.0	-	7.8	8.0	38.3	-	6.4
1968	21.6	-	14.1	15.5	11.7	3.0	5.1
1987	30.0	8.2	3.0	11.6	12.5	22.3	5.6
<b>Loan</b>							
1957	32.9	-	28.4	10.6	6.3	1.9	9.2
1962	38.2	-	13.9	7.7	13.5	-	10.4
1968	21.8	-	18.4	16.0	9.6	3.3	5.3
1987	32.9	3.9	0.8 3/	26.0	10.1	22.1	4.3
<b>Northeast :</b>							
<b>Loan</b>							
1962	56.0	-	6.7	5.8	4.1	-	4.6
1985	51.5	-	6.0 3/	27.9	22.7	-	-
1987	50.9	16.8	2.1 3/	27.9	0.7	1.2	0.0
<b>Contracts</b>							
1987	30.8	29.8	1.1 3/	9.6	7.5	1.1	0.0

Note: 1/ Not every type of lenders are included, So the sum for 1957-1972 is less than 100%

2/ "Rentiers" are rich persons who have income from property. They do not have labor income. Most of them have land for rent but do not lend money to their tenants. If they do, they will be called "landlords".

3/ Including professional lenders and salaried employees.

Source: From Poapongsakorn and Netayarak (1989) Table 3.2. Data from:

(1) 1957 : Uthis Naksawadi (1958).

(2) 1962 : Thisyamodol, et. al., (1965).

(3) 1968 : Uthis Naksawadi (1970).

(4) 1985 : Nipon Ponpongsakorn (1987).

(5) 1987 : Survey of Borrowers in 1987.

Most credit is either in cash or of short-term duration, or both. Credit in kind, e.g. fertilizer and paddy or rice, is also quite common in some areas. Medium and long-term credit is rather insignificant. The average amount of informal loans is much smaller than that of formal loans (usually less than a half). Although informal credit is generally said to be used mainly for consumption, a recent study indicates that a large proportion (71 percent) is used for production purposes (Poapongsakorn and Netayarak, 1988). According to Thani's study (1980) 50 percent of informal credit was used for non-farm enterprises (Also see Onchan and Prapaporn, 1982). Significantly, in Thailand, neither the BAAC, which is the most important agricultural credit institution, nor commercial banks provide credit for the non-farm activities of farm households. They do not give credit for consumption purposes either. The BAAC has, in recent years, given some minimal credit for consumption, but only in special cases. Credit for non-farm enterprises is recognized as increasingly important, but BAAC is not authorized to make such loans.<sup>1/</sup>

With regard to interest rates, institutional lenders are usually strictly regulated. They must abide by usury laws,

-----  
1/

Communication with Mr. Suwan Tripol, president of BAAC, indicates that BAAC has proposed such loans to its Board for several years without success. He intends to submit the proposals again.

which impose artificially low rates of interest. Since informal lenders elude regulation, they almost always charge higher rates. Although information costs are comparatively low for the informal lender, there are other factors that make their lending costs higher (Feder, et. al., 1988). In Thailand, the interest rates of informal lenders are usually about two to four times higher than those of formal lenders. For example, in 1986/87, BAAC's rate of interest was about 12.5 percent per year, while relatives and lenders were charging 26 percent and 56 percent, respectively (Ministry of Agriculture and Cooperatives, 1988). Data in Table 3 show the rates of interest of different types of informal lenders in certain regions over the selected years. The rates vary by type of lender and by regions. Relatives usually charge less than other lenders, but the rates are still much higher than those of formal sources of credit. Although it is often claimed that relatives do not charge interest, data from a survey in the Northeast indicate that, lending at zero interest rate, even within families, is rare<sup>1/</sup>. It does not appear that the interest rates of informal lenders have declined, even after the expansion of formal credit in 1975. In fact, the data from the Land Titling Project indicate that the standard rate is about five percent per month, and this rate has prevailed

-----  
1/

Personal interviews with a of few private moneylenders reveal that they usually charge interest at on-going rate to their relatives and friends. This is confirmed by data from the survey of the Land Titling Project at Kasetsart University.

Table 3: Interest Rates in the Informal Sector as Reported by Borrowers

(Percent per Month)

Regional/Lender Type	1957	1962	1968/69	1972/73	1981/82	1984/85	1987
1. Central Region (All Lenders)	3.08	2.30	1.98	-	3.26	-	3.1
Grain traders	3.67	2.40	2.33	-	4.05	-	3.1
Other merchants	3.50	2.70	2.41	-	-	-	3.6
Rentiers & lenders	3.08	2.1-3.8	1.94	-	3.94	-	4.0
Rice mills	3.00	-	2.17	-	-	-	2.7
Farmers	2.33	2.40	-	-	-	-	2.3
Relatives	2.08	1.70	1.50	-	2.54	-	2.2
Rice loans	1.45	-	4.84	-	-	-	6.9
Fertilizer	-	-	2.67	- 1/	-	-	3.8 1/
2. Northeast (all lenders)	-	4.30	-	4.24 1/	-	4.64	3.5 (5.0-7.0) 1/
Grain traders	-	6.20	-	-	-	5.57	4.1
Other merchants	-	3.90	-	2.94	-	5.51	2.3
Rice mills	-	7.30	-	4.78	-	6.03	1.0
Farmers	-	3.30	-	-	-	5.14	3.4
Relatives	-	1.80	-	4.20	-	2.82	2.9
Rice loans	-	-	-	-	-	7.65	-
Fertilizer	-	-	-	-	-	4.00	3.0
3. North (all lenders)	-	4.80	-	3.73 2/	-	-	4.6, 4.1 (5.0) 1/
Grain traders	-	5.40	-	3.88	-	-	4.0, 6.7
Other merchants	-	4.70	-	3.14	-	-	4.3, 5.1
Rentiers	-	5.00	-	4.00	-	-	3.4, -
Farmers	-	3.30	-	-	-	-	5.0, 3.6
Relatives	-	2.60	-	3.90	-	-	3.9, 2.7
Rice loans	-	-	-	-	-	-	3.9, 4.2
Fertilizer	-	-	-	-	-	-	6.5, 4.9

Note: 1/ Data for 1972/73                      2/ Data for 1971

For 1987 Northern data, the first column refers to the Lower North, and the second column to the Upper North.

Source: From Nipon and Prayong (1989) Table 4.1. Data are from:  
 (1) 1957 : Uthis Naksawadi (1958)                      (2) 1962 : Thisyamondol, et., al., (1965)  
 (3) 1968/69 : Uthis Naksawadi (1970)                      (4) 1971/72 : Thisyamondol, (1971), North  
 (5) 1972/73 : Thisyamondol, (1973), Northeast  
 (6) 1981/82 : Munjaition (1985)                      (7) 1984/85 : Poapongsakong (1987)  
 (8) 1987 : Survey of Borrowers in 1987

for several years (Dhaiyanonda, et. al, 1988). Data from the farm credit surveys by the Ministry of Agriculture and Cooperatives confirm this trend. The rate of interest of formal lenders in Thailand has also been rather stable, i.e. around 12-14 percent annually, during the past two decades.

Interest rates vary substantially among regions. An analysis of these variations in the informal sector suggest that borrower characteristics (e.g. land holdings, ownership of titled lands, and borrower's income), do not account for much of the variation. Characteristics of lenders and contracts (e.g. rice-mill owners, non-residency, loan size, and loan duration) seem to have more bearing (Poapongsakorn and Netayarak, 1988).

Loans in kind usually have higher interest rates. In Buri Ram province, a borrower gets two tang<sup>1/</sup> of paddy from the lender, usually a trader or grocery store owner. After harvest, he repays with three tang. The rate of interest will depend on paddy price and the duration of the loan. When the loan is in the form of fertilizer, repayment is usually in paddy. For example, for a loan of one sack of fertilizer worth 250 baht, repayment is seven or eight tang of paddy in seven months. In both cases, interest rates are very high.

-----  
1/

One tang of paddy = 20 kg. This is two time heavier than a regular tang which is only 10 kg.

Finally, the case of "land pawning" or "usufruct loans", which are common in the Northeast, should be mentioned. Many farmers leave their villages for work in Bangkok or overseas, often going to the Middle East. Instead of borrowing from a commercial bank to finance his travels, the farmer gets a loan from someone in his village. He surrenders the right to use his land to the lender. The lender can then farm it until the borrower pays him back. The interest, in this case, is the lender's net income from farming the land. Because of the increasing scarcity of arable land, such land lending is welcomed by local farmer lenders<sup>1/</sup>. Land pawning is common generally found in mainly subsistence economies where land values are relatively low and land markets inactive. The practice is seldom found in other regions the Upper North, for example where the rural economy is generally commercialized and land value is high. In these areas the farmer is better off borrowing from formal sources<sup>2/</sup>.

-----  
1/

The amount of the loan is determined by the price of the land. Usually, the lender is quite generous and willing to give a high price for the land if it is legally documented. One gets the impression that the lender would be pleased to foreclose. The loan contract is usually arranged in the presence of the village headman, who acts as a witness.

2/

Communication from Dr. Anan Ganjanapan, Head of the Anthropology department, Chiang Mai University.

## Land Collateral and Informal Credit<sup>1/</sup>

Loan transaction typically involve the risk of borrower default. Lenders are always trying to reduce this risk and to minimize such losses. Collateral and guarantees are used universally to increase the lender's expected profit from a transaction. Collateral increases the lender's expected return and spurs the borrower to avoid intentional default. In developing countries, land is the most common collateral in rural areas. Informal lenders are less inclined to accept land as collateral, lenders who do not have links to borrowers in matters other than finance are more likely to use loan securities. In this section, a brief mention will be made of the role of collateral and other guarantees in rural credit, particularly informal credit. The data pertain to samples of borrowing farmers from four provinces. The farmers are separated into two groups, namely farmers who have titles to their land, and untitled farmers<sup>2/</sup>.

The data show that titled farmers provide land as collateral in 63% of the institutional loans sampled. Non-institutional or informal loans are mostly granted with no

---

1/ This section is drawn heavily from Feder, Onchan and Raparla, (1988) and Feder et. al., 1988 (Chapter 5).

2/ Details on research methodology and other related matters can be found in Feder, et. al., 1988.

collateral or other security. However, for the few informal loans which involve any security, the most common security is land collateral.

The data on the distribution of loans indicate that the importance of traders as a source of credit increases with the degree of commercialization of the province. In Lopburi province, for example, nearly half of all loans and the bulk of non-institutional credit are provided by traders. Lending by relatives and neighbors declines with higher degrees of commercialization. To judge by the interest rates charged, even many of these loans are commercial transactions priced at market rates. Some are intrafamily transactions, however, which carry low or zero rates of interest. Further, the data also show that farmers without land titles (without collateral) depend more on non-institutional lenders.

The data from the survey also give the mean rate of interest on loan from institutional and non-institutional lenders and the composition of lending maturities. Clearly, because institutional credit in Thailand is subject to an interest rate ceiling, loans from regulated institutional creditors are substantially cheaper. Most loans are short-term-twelve months or less. Medium-term and long-term loans are provided by institutional lenders more than by non-institutional lenders. Farmers with land titles obtain such loans much more often than do farmers without them. This is compatible with the observation

that farmers without titles lack acceptable land collateral and are thus perceived by institutional lenders as potentially high risk clients, other things being equal.

As non-institutional lenders have superior information about borrowers, they are less inclined to require collateral or collateral substitutes. Data in Table 4 reveal that an overwhelming majority of non-institutional loans are granted without collateral. In contrast, the majority of institutional loans are covered by collateral or collateral substitutes. In the few instances in which collateral was provided on non-institutional loans, land was the predominant form. Farmers without titles are obliged to provide a collateral substitute, namely a group guarantee, to obtain institutional loans. However, group guarantees are less desirable than land as collateral. A group guarantee can, therefore, be expected to provide a smaller amount of credit. This is confirmed by the data on loan amounts per unit of land owned presented in Table 5. In all four provinces, institutional loans covered by land as collateral are larger than loans without collateral or loans with group guarantees. As regards the amount of loans provided by non-institutional lenders, the importance of collateral varies among the provinces. With the exception of Lopburi<sup>1/</sup>, land

-----  
1/

The special case of Lopburi, where farming is more advanced than in other three provinces, cash crops are grown, and the linkage between credit and marketing is strong, is explained in Feder et. al., 1988. In this province, non-institutional credit is readily available without land as collateral.

Table 4: The Distribution of Loans, by Source and by Type of Collateral

(Percentage of Loans Made)

Type of Collateral	Province								
	Lop Buri		Nakhon Ratchasima		Khon Kaen		Chaiyaphum		
	Untitled	Titled	Untitled	Titled	Untitled	Titled	Untitled	Titled	
							With STK	Without STK	
<b>Intitutional lenders :</b>									
- Number of borrowers in sample	86	50	54	50	20	30	11	38	50
- No collateral	14	4	48	14	25	10	0	0	0
- Land	8a	78	6a	54	10a	47	18a	11a	56
- Third-party guarantee	1	0	2	0	0	0	0	13	0
- Group guarantee	77	18	44	32	65	43	82	76	44
<b>Non-institutional lenders :</b>									
- Number of borrowers in sample	74	68	22	19	22	15	13	23	27
- No collateral	93	79	86	84	64	87	100	91	77
- Land	7a	21	9a	11	4a	7	0	4a	15
- Other	0	0	5	5	32	6	0	4	8

a. Some untitled farmers' homes and the lots on which they are built are located outside the

boundaries of state land and may therefore be offered as collateral. The number of such farmers is small.

Source: Feder, Onchan, Chalamwong and Hongladarom, 1988, Table 11, p. 54.

Table 5: Average Amount of Loan per Rai Owned, by Type of Security and Type of Lender

(Baht per Rai)

Type of Loan Security	Province							
	Lop Buri		Nakhon Ratchasima		Khon Kaen		Chaiyaphum	
	Institu- tional Lenders	Non-Insti- tutuional Lenders	Institu- tional Lenders	Non-Insti- tutuional Lenders	Institu- tional Lenders	Non-Insti- tutuional Lenders	Institu- tional Lenders	Non-Insti- tutuional Lenders
No security	324	563	262	105	114	153	n.a.	72
Number of loans	14	137	40	41	10	49		55
Group guarantee	297	n.a.	178	n.a.	290	n.a.	259	n.a.
Number of loans	77		65		45		60	
Land collateral	372	402	427	373	776	524	319	104
Number of loans	52	21	44	4	19	4	34	5

n.a. = not available

Note: 26 baht = US\$1; 625 rai = 1 hectare

Source: Feder, Onchan, Chalawong and Hongladarom, 1988, Table 12, p. 56

collateral seems to offer advantages even in the non-institutional credit sector.

The data presented above provide useful insight into the role of land collateral in the informal sector. Although land collateral is generally not required by informal lenders, it does help increase access to informal credit. A further insight in this regard may be gained by looking at the data from other studies, although this kind of data is very limited. The data from a survey in Buri Ram, for example, reveal that for a loan of over 5,000 baht, a written contract and some kind of security are required. As the amount of credit gets bigger, the need for land collateral will become greater (Charan et. al., 1988 and also from personal interview with informal lenders). Further, it is not an unusual practice for the lender of a large loan to keep a land document of the borrower. This, among others, reasons is to prevent the borrower from obtaining a large loan from another lender. The data from a farm debt survey in 1986/87 also indicate that a good proportion of informal credit requires loan security. Among the informal lenders, the merchants require land collateral more than other types of lenders (Ministry of Agriculture and Cooperatives, 1988).

To conclude, land collateral affects access to credit from both formal and informal sources, particularly the formal ones. It has also been shown that land collateral is required by informal lenders, particularly when the loan amount is large

and when medium and long-term credit is needed. Therefore, land ownership security is very important in farm financing. Hence the Land Titling Project which is being carried out in Thailand will increase access to rural credit.

#### Why Informal Credit?

The advantages of borrowing from informal lenders are now quite well known. Informal credit is more accessible than formal credit. There is no complicated procedure involved, hence it can be obtained in a very short time. In general, no collateral is required. Therefore, it is very popular among the small and landless farmers. The terms of credit are also very flexible particularly with regard to the amount, the purpose, the duration, the type and, in some cases, the rate of interest of the loan. As mentioned before, in the informal sector information regarding the borrower plays an important role in credit transactions. The interlinkages between credit and marketing are also very strong in the case of Thailand.

Available data on the reasons for borrowing from informal sources indicate that 40 percent of the borrowers from informal sources because it saves time and no collateral is needed. Other reasons include: i) inability to borrow from formal sources as they have not yet paid back previous loans (20%), ii) do not know how to borrow from the formal source (24%), and iii) borrowing for consumption, which is not provided by formal sources (16%) (Thani, 1980). These findings indicate

that the kinds of services given by informal lenders appear to serve the farmers well.

Another important service of informal credit is the provision of credit for non-farm enterprises of the farm households. As mentioned before, in Thailand, formal sources do not usually give credit for non-farm enterprises. The data from a Chiang Mai province study reveal that about 50 percent of the credit for non-farm enterprises comes from informal sources. The rest of the funds come from savings. Formal credit constitutes a very insignificant portion. Considering that non-farm enterprises are very important to rural households in terms of income and employment, informal credit is providing a useful service (Onchan, 1989).

With regard to the issue of market efficiency and exploitation of farmers by informal lenders, the question of monopolistic power is relevant. Available data on this is not conclusive. However, it has been observed that some monopolistic practices exist and that the informal market is not efficient (Siamwalla, 1988). This difficult issue of market competitiveness and efficiency will need to be further investigated if any concrete conclusion is to be reached.

In this connection, it is interesting to note how the farmer borrowers feel about the moneylenders. The data from the Chiang Mai survey indicate that about 80 percent of the borrowers

do not think that they have been taken advantage of by informal lenders and over 60 percent feel that there is no need to change the lending practices of informal lenders. Many borrowers (16%) wish to have more informal lenders, but also to have some reduction of the interest rate. When asked if they had to borrow more than they do now, from whom would they borrow, over 70 percent of the borrowers said they would like to borrow from non-commercial informal lenders (i.e. relatives and friends) because the interest rates are low. On the other hand, only 10 percent wanted to borrow from formal sources for the reason of low rates of interest (Thani, 1980).

Even though the data as indicated may not be sufficient to adequately evaluate the attitudes toward informal lenders, it does point out the kind of services which are quite acceptable to the borrowers. From a personal interview of a group of borrowers, in Buri Ram province, it has become rather clear that their overall attitude toward informal lenders is generally positive. They can usually rely on these lenders at times when credit is needed for various purposes, farm and non-farm or consumption and production. The types of credit being offered appear to accord well with the needs of the farmers. There is enough flexibility regarding the terms of credit such as collateral requirements, forms of contracts, length of time, and repayment schedule. The interest rate is probably the most negative aspect of informal credit. However, borrowers seem to accept the rates without much complaint. Since the duration of

the loan is usually rather short (in most cases less than 6 months) and the loan amount is also small (less than half of that of the formal lenders), from the point of view of the borrower the problem of high interest rates is somewhat minimized.

### **Lessons from Informal Credit Markets**

Over the past fifteen years, the new agricultural credit policy has been carried out quite successfully as judged by the phenomenal increase in the supply of institutional credit and by the substantial decline in size or market share of informal credit. However, it is difficult to evaluate the economic impact of the credit policy. Over the period, agricultural production has increased at the relatively high rate of 5 percent per annum while the annual growth of total productivity is about 3 percent. Furthermore, agricultural diversification has been achieved and new technology adopted in many areas. The production performance of Thai agriculture has been indeed very impressive. Nevertheless, equity remains an important issue as income distribution is still very unequal within the rural sector itself and also between rural and urban sectors. In this connection, it has been mentioned very often that the tremendous expansion of cheap credit has gone mostly to the hands of relatively large and rich farmers and that the current credit policy might have contributed to the worsening of income distribution in Thai agriculture.

Available data on the distribution of formal credit point out clearly that small and landless farmers have not been able to obtain institutional credit. They still depend almost totally on informal sources. As already mentioned in this paper, the informal credit market is still very active and it is providing useful and acceptable services to the farmers. In the meantime, formal lenders, namely the BAAC, are still searching for a more effective way to reach small farmers. Starting this year, under a directive from the Ministry of Finance, BAAC is providing loans directly to groups of low income farmers in the amount of 1,000 million baht per year. This program will continue for 5 years. The credit is granted to the groups without collateral. As is usually practiced by BAAC, group guarantees are also applied here. The results of this policy are not yet known. In fact, BAAC will find it difficult to manage the program to meet the target. In an attempt to reduce transaction costs, BAAC is considering using farmer leaders, i.e., village headmen, to act as its "agents" in the villages. The agent will help BAAC in loan processing by using his knowledge or information about the borrowers. He will be paid by the Bank for his services.

What BAAC is trying to do is to obtain information about potential borrowers in the village which informal lenders now already have. As its loan agent, BAAC expects the village leader to help improve the loan processing procedure and the rate of repayment. Although the agent cannot be in the same

position as the informal lenders, he still is respected by the farmers. Hence, his personal contact may help improve the operational efficiency, particularly in regard to the transaction costs of the bank.

The case of BAAC just cited demonstrates an admirable attempt by a formal lender to try to learn from the informal lenders. Formal lenders now know well why informal lenders can perform better in providing services to the poor farmers who are being neglected. "Flexibility" is an important aspect of rural financing which most formal lenders must endeavor to emulate. However, it is not possible to be as flexible as the informal lenders, particularly with regard to such aspects as business hours (evenings, Saturdays and Sundays, for example) and credit for consumption and non-farm activities. However, as already mentioned, BAAC is now providing a very small amount of credit for consumption purposes. For this type of credit, BAAC is taking special caution as it could have harmful effects on its operations. Nevertheless, this is an encouraging sign.

As regards credit for non-farm enterprises, BAAC has also given it much attention. The importance of non-farm enterprises to the welfare of the rural households is well recognized. and BAAC is determined to give this kind of credit service. pending the approval of its board. Again, this is a response to a useful lesson from the informal credit market.

As for collateral requirements, BAAC is somewhat flexible as a good part of its lending program does not require collateral. Group credit has long been practiced by BAAC with some degree of success. However, for large and long-term loans, land collateral is still required. In fact, this is also the case with informal lenders. However, the apparent difference between the two types of lenders is that informal lenders provide mainly small loans of short duration to individuals. This is made more flexible by the lender's keeping the borrower's land document without any proper registration with the Land Office. This cannot be done by the BAAC.

It has also been suggested that a formal lenders can use an informal lender as "agents" for the delivering of loans to all types of clients (Onchan, 1977). This, in fact, has been practiced in some countries. However, in practice, this may pose several problems particularly in regard to the distribution of loans, supervision, and the misuse of the funds. Besides, it is not easy to identify an informal lender who wants to cooperate with a government-owned bank like the BAAC.

Finally, the persistent issue of interest rates is not likely to be resolved in the near future. Without the liberalization of interest rates to reflect the opportunity cost of capital, the high risk, and the transaction cost of lending, it will be difficult to attain efficiency in the credit operations of formal credit markets. It is mainly for this

reason that informal credit markets have been enjoying a much greater advantage over their formal counterparts.

### Summary and Conclusions

Informal credit will continue to be important in rural finance in Thailand for years to come. Informal lenders include relatives and friends (non-commercial) and professional moneylenders, landlords, merchants, and rich farmers (commercial lenders). Non-commercial lenders provide loans at a low rate of interest which are, nevertheless, generally about two times higher than that charged by formal lenders. Charging no interest has become less common than before among this group of lenders. Although there are several informal lenders in the market, some monopolistic power still exists. A borrower usually relies on a particular informal lender.

The average loan amount of informal lenders is very much smaller than that of formal lenders. Informal credit is mostly short-term. Collateral is usually not required unless the size of loan is big, and a written contract is necessary. Informal credit is for both production and consumption, although consumption loans may be more significant. Further, it is also available for the non-farm enterprises of the rural households.

The interest rates for informal credit are generally much higher than those for formal credit. There is, however, a great variation of interest rate among different regions,

different types of lenders, and different types of farming. Factors which were found to explain the regional variation of interest rates include lender and contract characteristics.

Land ownership security or collateral affects access to both formal and informal credit. Without land collateral, farmers will have to depend mostly on informal credit. Furthermore, with land collateral, they can get more informal credit. If they want to take a large informal loan, they must have collateral. As land ownership security has been a serious problem in Thailand, other forms of loan security have also been used. Fortunately, for the past five years, the Land Titling Project has been effective in speeding up the land titling process. This project will help improve the collateral situation and, hence, farm credit markets in rural Thailand.

Informal lenders have been providing useful services to the Thai farmers. Credit for various purposes is usually available at flexible terms. Most farmers feel that they are not being taken advantage of by informal lenders and, in fact, are quite satisfied with the services provided. Although the overall efficiency of informal credit markets is still questionable, their credit operations are generally quite efficient as indicated by the speed of credit delivery and the relatively low cost of transaction. Furthermore, they are also providing the necessary credit for consumption and non-farm enterprises which are not usually given by formal lenders in Thailand.

In attempting to reach the majority of farmers, particularly the small and landless ones, formal lenders in Thailand are learning from the informal markets. BAAC has taken up new approaches of lending which include group credit, project loans, and consumption credit. It is also trying to introduce non-farm credit to its clients. Further, it plans to appoint a credit agent in the village to help speed up its loan processing, to reduce transaction costs and to improve loan repayments.

Finally, more research on informal finance is needed.<sup>1/</sup> Although careful analysis of informal credit has been conducted in recent years, the data on certain aspects of informal finance are still limited. Rural savings in the informal market is one example. Interlinkages of informal credit with land and labor markets and with product marketing is another area which needs to be carefully investigated. The analysis of the behavior of the non-commercial lenders may be useful in giving an insight into informal credit which usually is overlooked by researchers.

-----  
1/

Research in informal rural finance will encounter methodological problems. Conventional sampling techniques may not be appropriate. Data collection is difficult and costly. Usually, informal lenders are reluctant to give out information about their operations. For those who are willing to cooperate, some information will be confidential (e.g. interest rates charged, and collateral handling). Very often, researchers have to depend on interviews with borrowers and other well-informed villagers. However, these people cannot give all the relevant and necessary information about the lenders. Hence, research methodology should be carefully discussed and designed before the commencement of any research undertaking.

"Usufruct loans" which are widely practiced in the Northeast are also interesting. A case study of informal lenders as credit agents for formal lenders can also be worthwhile. It is hoped that with more information about informal credit better understanding among policy makers and other concerned people will be gained. With an understanding of the significance of and the role played by informal lenders, especially among small and landless farmers, a more flexible or liberalized interest rate policy may become acceptable and be adopted by policy makers. This, in turn, will help improve the efficiency of rural financial markets in Thailand.

## References

- Dhaiyanonda, Charan, Tongroj Onchan and Yongyuth Chalamwong. "Farm Credit and Land Titles : Case Study of Buri Ram Province". Center for Applied Economics Research, Kasetsart University, 1988.
- Feder, Gershon, Tongroj Onchan, Yongyuth Chalamwong and Chira Hongladarom. Land Policies and Farm Productivity in Thailand, John Hopkins, 1988.
- Feder, Gershon, Tongroj Onchan, and Tejaswi Raparla. Collateral, Gurantees and Rural Credit in Developing Countries : Evidence from Asia. Agricultural Economics, Amsterdam, 1988.
- Naksawadi, Uthis. Debt Situations of Farmers and Rice Marketing in the Central Region of Thailand, 1957-1958. Office of Agricultural Economics. Ministry of Agriculture & Co-operatives, (Thai), 1958.
- . Reserch Report on Debt Situation and Paddy Marketing in the Central Region of Thailand, 1967-1968. National Reserch Council and USOM (Thai), 1970.
- Office of Agricultural Economics. Ministry of Agriculture & Co-operatives. Debt Conditions of Thai Farmers (Thai), 1977, 1978/79 and 1986/87.
- Onchan, Tongroj. Agricultural Credit in Asian Countries : Review of Past Decade. Paper presented at the Seminar on Farm Credit, Asian Productivity, Tokyo, 1985.
- Onchan, Tongroj, Yongyuth Chalamwong and Chira Hongladarom. Land Tenure Security and Farm Productivity in Thailand. Staff Paper, Dept. of Agricultural Economics, Kasetsart University, 1982.
- Onchan, Tongroj. Agricultural Credit Policy in Asia. Staff Paper. Department of Agricultural Economics, Kasetsart University, 1974.
- Onchan, Tongroj. Non-Farm Enterprises, Employment, and Rural Development. Paper presented at the Symposium on "Measures for Rural Employment Generation", Asian Productivity Organization, 7-12 September, 1989.
- Onchan, Tongroj and Prapaporn Thanomvongthai. Informal Credit and the Development of Non-Farm Enterprises. A Research Report. prepared for USAID, 1982.

## References (con.)

- Pinthong, Chirmsak and Prayong Netayarak. Portrait of Money Lenders in Thai Rural Credit Market. Ressearch Report for Thai Khadi Research Institut. Thailand Development Research Institute and Faculty of Economics, Thammasat University. (Thai), 1987.
- Poapongsakorn, Nipon and Prayong Netayarak. Regional Variations in Rural Interest Rates. A Reserch Report Submitted to Asian Development Bank and TDRI, 1989.
- Siamwella, Ammar (ed.). Rural Credit Market in Thailand. Thailand Development Research Institute and Faculty of Economics. Thammasat University (Thai). 1988.
- Thisyamondol, Phantum, V. Arromdee and M.F. Long. Agricultural Credit in Thailand-Theory Data, Policy. Bankgok : Kasetsart University), 1965.